

DOS Actions Regarding Internet Banking

Audit Report No. 99-043
October 27, 1999

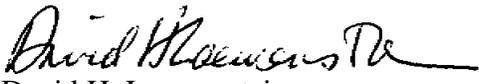


OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

DATE: October 27, 1999

TO: James L. Sexton, Director
Division of Supervision

FROM: 
David H. Loewenstein
Assistant Inspector General

SUBJECT: *DOS Actions Regarding Internet Banking*
(Audit Report No. 99-043)

The Federal Deposit Insurance Corporation's (FDIC) Office of Inspector General (OIG) has completed an audit survey of the FDIC's actions regarding Internet banking. The Division of Supervision (DOS) established electronic banking examination (EBE) procedures to address evolving areas of electronic banking, including Internet banking. DOS's procedures generally provide a sound framework for evaluating Internet banking practices at FDIC-supervised financial institutions. However, our survey identified several opportunities to improve the procedures and their implementation that, if adopted, will enhance DOS' supervisory activities related to Internet banking.

BACKGROUND

Internet banking is the most recent aspect of electronic banking being pursued by the banking industry. According to recent statistics reported by Ernst & Young, some level of Internet services will be offered by 65 percent of U.S. banks during 1999, up from 18 percent in 1998 and 5 percent in 1997. Ernst & Young also projects that 52 percent of U.S. banks will assist corporations in initiating transactions over the Internet, up from 13 percent in 1998 and 3 percent in 1997. Such growth is attributable to the low product or service distribution costs characteristic of the Internet.¹ These decreased costs offer participating banks the opportunity to offer improved services at lower costs to the consumer.

Prudent business acumen normally associates higher returns with higher risk. The same concepts apply to financial institutions that offer Internet banking services to their customers. The principal benefits of Internet access, namely its global reach and open architecture, present significant security risks. These risks, along with an increased dependency on computers in general, pose significant challenges to the banking industry. For example, recent intermittent Web outages at one of the largest electronic bill payment service providers adversely impacted

¹ Internet's E-economy Gets Real, Mark Leibovich, Tim Smart, Lanthe Jeanne Dugan, The Washington Post, Page A1, June 20, 1999.

nearly half a million customers at about 20 large banks.²

Aware of these trends, the U.S. General Accounting Office (GAO) recently completed an audit and issued a report entitled *Electronic Banking: Enhancing Federal Oversight of Internet Banking Activities* (GAO/GGD-99-91, July 1999). The report commended the FDIC for its proactive approach to examining Internet banking but cited an area that could benefit from management's attention. This area is the need for greater examination coverage of outside servicers conducting Internet banking.

To address the growth and risk of Internet banking, DOS established its EBE procedures in January 1997 and refined these procedures in June 1998. FDIC examiners use the EBE procedures to guide them in evaluating Internet banking at financial institutions. DOS has also played a leading role in the FDIC's New Banking Technologies Task Force and CyberBanking Speaker Series, both of which have contributed to raising the FDIC's level of awareness concerning Internet banking and its related risks. Additionally, DOS has established an easy-to-use FDIC Intranet Web site containing examiner aides such as a current list of known banks with an Internet presence. Furthermore, DOS uses three management systems to track information related to bank examinations involving Internet banking. They include the Electronic Banking On Line Data Entry System (EBOLDES), the Banking On Line Tracking System (BITS), and the Scheduling Hours and Reporting Package (SHARP).

The EBE procedures use three risk levels to categorize a bank's Internet activity and the associated level of examination. Level one pertains to information-only sites that allow access to general-purpose marketing and other publicly available information or the transmission of non-sensitive electronic mail. Level two relates to electronic information transfer systems that are interactive in that they provide the ability to transmit sensitive messages, documents, or files between financial institutions and users. A level three designation is used for institutions that provide transactional banking services, such as transferring funds. The results of the FDIC's Internet banking examinations are incorporated into the management component of the uniform financial institution rating used to measure an examined financial institution's safety and soundness.

The Federal Financial Institutions Examination Council (FFIEC) Information Systems (IS) Examination Handbook and a draft version of comprehensive information technology (IT) technical procedures supplements the safety and soundness EBE procedures. These technical procedures are intended for use by electronic banking subject matter experts (ESME) or IS examination specialists. To support the implementation of these procedures, DOS established an EBE procedures training program and an ESME program. DOS intends for the ESME program to supplement DOS's IS examiners by creating a group of safety and soundness examination staff proficient in examining electronic banking technology. The FDIC employed 197 ESMEs at the commencement of our survey, including IS examination specialists at the regional and field office levels.

² Computer Glitch At CheckFree Snags Online Banking, Rebecca Buckman, The Wall Street Journal, Page 10, April 29, 1999.

DOS temporarily discontinued ESME training during 1999 to focus its resources on Year 2000 issues. Additionally, ESMEs in DOS's Atlanta, Boston, and Dallas regional offices indicated that they had devoted little time to Internet banking activity in light of the Corporation's focus on Year 2000 issues. DOS indicated that it plans to resume ESME training in 2000.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our survey was to identify and evaluate DOS practices regarding Internet banking to determine the nature, timing, and extent of audit procedures needed to further evaluate the effectiveness and efficiencies of these practices. To address this objective, we evaluated the (1) effectiveness of the DOS EBE procedures as applied to Internet banking and (2) degree to which DOS examiners were following EBE procedures during Internet banking examinations.

We interviewed FDIC personnel from DOS's Planning and Program Development and Operations Sections in Washington, D.C. We also interviewed DOS examination staff in Atlanta, Georgia; Boston, Massachusetts; and Dallas, Texas. We reviewed DOS's EBE procedures and safety and soundness Internet banking examination results contained within EBOLDES, BITS, and SHARP. We also reviewed three sets of working papers representing levels one, two, and three Internet banking examinations. Furthermore, we interviewed GAO representatives who had previously conducted a review of electronic banking examinations so that we could avoid duplicating their work.

Our survey focused on safety and soundness examinations involving Internet banking conducted between January 1, 1999 and February 28, 1999 so that our work would supplement the work performed by GAO and provide enhanced value to DOS. This focus also increased assurance that our conclusions regarding institution Web sites would be based on conditions similar to those encountered by DOS during examinations conducted in a comparable time frame to the original examination dates. We judgmentally sampled 3 of 54 safety and soundness examinations involving Internet banking to verify whether the examinations conformed to EBE procedures. We also determined for this same time frame whether Internet banking existed at examined financial institutions previously reported as having none and whether examination levels applied to Internet banking activity were consistent with DOS policy. During our survey, we documented our understanding of DOS's Internet banking examination process using a control flowchart. At DOS's request, we provided a copy of the flowchart for use in DOS training initiatives. We conducted our audit survey between January 1999 and May 1999 in accordance with generally accepted government auditing standards.

Based on our survey, we determined that further audit work would provide increased value to DOS if we delayed it until DOS had the opportunity to address the issues described in this report. The extensive use of outside service providers by banks offering Internet banking, the limited number of servicer examinations, and needed improvements in the structure and content of examination working papers reduced the value of conducting additional audit work at this time. After allowing time for DOS's program to mature and incorporate what we view as needed enhancements, we will revisit such an audit within the next 12 to 18 months to assess the effectiveness of the Internet

banking examination process. This audit would more thoroughly evaluate examination working papers and other factors related to the implementation of the DOS examination program.

RESULTS OF AUDIT SURVEY

Although our survey was based on a limited sample of DOS Internet banking activities, our observations indicate that DOS's Internet banking examination process provides a sound framework for examining Internet banking at financial institutions supervised by the FDIC. In addition, DOS's application process for deposit insurance addresses new banks that are totally Internet-based. Further, DOS has established EBE procedures that should contribute to effective examinations, and most examiners have received training on these procedures. DOS also established a review process for examination reports disclosing Internet banking issues and a central repository to track the results of examinations involving Internet banking.

While these actions are positive and reflect DOS's awareness of the increasing impact of Internet banking on the safety and soundness of financial institutions, we identified opportunities to enhance the Internet banking examination process. DOS's implementation of planning procedures can be refined to ensure that examiners use the Internet and the FDIC intranet during examination planning to identify Internet banking activities of institutions scheduled for examination. EBE procedures can also be expanded to instruct examiners how and when to make key determinations and to improve EBOLDES data integrity. In addition, the EBE procedures can be clarified to ensure documented examination determinations, the use of scoping or planning memorandums, and independent work paper reviews.

We also noted an issue similar to one reported by GAO regarding examination coverage of Internet banking service providers. Specifically, DOS had not performed examinations of most service providers that supported institutions offering transactional Internet banking services. Because GAO addressed this issue, we are not including any recommendations in this report. However, we encourage DOS, working in conjunction with the FFIEC, to continue its efforts to establish an examination program for Internet banking service providers.

IMPLEMENTATION OF PLANNING PROCEDURES COULD BE IMPROVED

Examiners did not always take advantage of available Internet and FDIC Intranet resources during examination planning to determine whether the bank to be examined had an Internet presence and the extent of services offered. For the three exams selected for review during our survey, we noted no evidence that examiners had used available Internet and FDIC Intranet resources during pre-examination planning. Subsequent discussions with the examination teams indicated that they had not checked for the existence or extent of the institution's Internet presence during exam planning.

Although EBE procedures suggest that examiners use the Internet and FDIC Intranet during examination planning to determine whether institutions to be examined have an Internet presence and the extent of services offered through such a presence, they do not require such use. In

addition, EBE procedures did not require that Internet banking examination planning be documented through a scoping or planning memorandum. The limited amount of time expended on examinations may have contributed to examiners not using the Internet and FDIC Intranet. During the first quarter of 1999, average time spent on Internet banking portions of examinations ranged from 3.6 hours to 14.1 hours as reported in SHARP.

Independent verification of information provided by financial institutions can enhance DOS's knowledge and understanding of institution operations during the planning process and can assist management in scheduling and assigning appropriate resources. DOS examiners did not identify Internet banking activity for 4 of 26 institution examinations sampled (see table 1). In addition, examiners did not perform the level of examination procedures consistent with transactional Internet banking at 3 of 10 institutions sampled (see table 2).

Table 1: Instances of Overlooked Internet Banking

Number	Comments
Sample Bank 1	Fully Transactional Site (level three) included on 1/29/99 FDIC List of Internet Banks.
Sample Bank 2	Information Only Site (level one) in which both site content and bank personnel substantiate site's existence at time of exam. Omitted from 1/29/99 FDIC List of Internet Banks.
Sample Bank 3	Information Only Site (level one) in which bank personnel substantiate site's existence at time of exam. Omitted from 1/29/99 FDIC List of Internet Banks.
Sample Bank 4	Information Only Site (level one) included on 1/29/99 FDIC List of Internet Banks.
Total 4	From a sample size of 26 examinations during the period of 1/1/99 to 2/28/99 (15% error rate) reporting no internet banking presence.

Source: EBOLDES and OIG analysis.

Table 2: Instances of Internet Banking Exam Level Non-Performance

Number	Comments
Sample Bank 1	Examiner noted within EBOLDES that site was transactional but performed only level-two exam without explanation.
Sample Bank 2	Examiner noted within EBOLDES that funds transfer capability existed but performed only level-two exam without explanation.
Sample Bank 3	Examiner noted within EBOLDES that funds transfer capability existed but performed only level-two exam without explanation.
Total 3	From a sample size of 10 examinations during the period of 1/1/99 to 2/28/99 (30% error rate) reporting an Internet banking presence.

Source: EBOLDES and OIG analysis.

In addition to not addressing prevailing risk by overlooking or understating Internet banking activity and omitting examination procedures, DOS's ability to effectively plan for upcoming examinations was impacted. Incomplete planning can reduce or preclude the needed involvement of ESMEs and IS exam specialists in examinations.

Recommendations

We recommend that the Director, DOS, ensure that:

- (1) Examiners use the Internet and FDIC Intranet during exam planning to correctly identify the existence of and apply the examination procedures consistent with the Internet banking activities at financial institutions.
- (2) EBE training emphasizes using the Internet and FDIC Intranet during the planning phase of future electronic banking examinations.
- (3) Examiners document their research of institution Internet banking activity within examination working papers and scoping or planning memorandums.

ELECTRONIC BANKING EXAMINATION PROCEDURES NEED EXPANSION AND CLARIFICATION

DOS's EBE procedures can be improved to assist examiners in determining and documenting whether an institution's Internet banking site is connected to its internal computer systems and when to make this and other key examination determinations.

DOS's EBE procedures address several key examiner determinations to be made during the Internet banking examination process. Such determinations include whether (1) Internet banking exists, (2) the institution's Internet banking site is connected to its internal computer systems, (3) the Internet banking offered is information only, information exchange or transactional, and (4) an ESME or IS examination specialist should be consulted during the planning and performance of the examination. Key examiner determinations should be documented because they govern the level of examination coverage and provide support for examiner decisions. Documentation also facilitates supervisory review of the decision-making process and provides assurance that the examination was conducted in accordance with management's intentions.

DOS can improve documentation related to key examination determinations. The DOS Internet banking examination working papers reviewed did not consistently provide a viable audit trail to facilitate management review of the examination process. Work programs were incomplete and supporting exhibits unavailable for some conclusions in all three sets of working papers. For example, four relevant pages of the core analysis work program, which forms the basis for examiner conclusions on Internet banking capabilities and risk, were not completed for one examination. In a second examination, the core analysis procedure called for determining the adequacy of the electronic banking security program but was marked as not applicable. A third set of working papers contained no response for the procedure that called for determining whether management verifies the accuracy and content of interactive programs. By enhancing documentation of key determinations and the actions taken while making these determinations, DOS can further enhance confidence in examination results.

Determining whether Internet banking exists is the first step in ascertaining whether to apply Internet banking exam procedures during a planned examination. This step involves verifying whether the bank has an Internet presence via the Internet and FDIC Intranet and confirming the currency of references to Internet banking, if any, from previous examinations. None of the three sets of examination working papers reviewed during our survey contained evidence of such a verification during examination planning. Subsequent discussions with examiners indicated that the verifications were not performed.

After determining whether an institution has an Internet presence and the level of activities associated with such a presence, the examiner must determine the related risk. The first factor in assessing the risk posed by an institution's Internet banking activity is determining whether connectivity exists between an institution's Internet banking site and its internal computer systems. This determination dictates the level of technical expertise needed by examination personnel to evaluate the Internet banking activity and influences the timing and extent of an ESME or IS examination specialist's involvement on the exam. None of the three sets of examination working papers that we reviewed contained evidence of such an analysis.

The next factor in assessing risk associated with an institution's Internet banking activity involves determining whether an Internet banking site is information only, information exchange or transactional. An informational Internet site is limited to the display of information related to a bank and its customers. Transactional sites permit customers to transfer information and process financial transactions. As noted in our previous audit condition, examiners experienced some difficulty making this determination.

Finally, the examiner must determine whether and when an ESME or IS examination specialist should be consulted to ensure that the requisite technical expertise is applied to the examination on a timely basis. Such involvement ensures that the examination team applies the necessary technical examination procedures and addresses all applicable Internet banking exposures. Consultation between the safety and soundness examiner and ESME was not documented in any of the three sets of working papers reviewed. In addition, two of the three sets of working papers did not conform with DOS EBE procedures regarding the review level performed. For example, the examination working papers for a level-three examination contained no evidence of a technical review by a designated ESME or IS exam specialist or an explanation describing why the exam team omitted the technical review.

Although DOS's EBE procedures encourage performing and documenting the determinations described, they do not require them. Additionally, the procedures do not require a review of Internet banking examination working papers to ensure their quality. Evidence of ESME, IS exam specialist, or other review was not reflected in the working papers reviewed during this survey. We believe that the lack of documentation and independent review for these examinations was caused, at least in part, by DOS not requiring these actions. As a result, working paper conclusions and the report of examination were not consistent for two of the three sets of working papers reviewed. In one case, examination conclusions noted inadequate electronic banking policy and the report identified the matter as requiring the attention of the financial institution's Board of Directors. However, the examiner assigned a management component rating of one, the best rating available. In another instance, the examiner's working papers contained only an expired contract with the institution's servicer and the examiner omitted evidence of a review of this servicer's security or virus protection. However, the examination report's risk management section for electronic banking indicated that the bank's Internet site through the servicer was adequately controlled and that it used both virus protection and security software.

Recommendations

We recommend that the Director, DOS, ensure that:

- (4) EBE procedures are revised to require: (a) detailed instructions on determining the connectivity between an institution's Internet banking site and its internal computer systems and when to make this and other key examination determinations; (b) key Internet banking examination process determinations be documented within the working papers; and (c) Internet banking examination working papers and reports be independently reviewed and that evidence of this review be retained in the working papers.

CONCLUSION

In recognition of the substantial risk that Internet banking poses to the banking industry, DOS, through its EBE procedures, has established a sound framework for evaluating Internet banking at supervised financial institutions. However, the noted opportunities for improvement are critical to ensuring effective implementation of this framework. Along with the GAO, we also encourage DOS to continue its efforts to establish an examination program for Internet banking service providers.

Additional audit work will provide more benefit to DOS if we delay it because of the extensive use of outside service providers by banks offering Internet banking, the limited number of current servicer examinations, and needed improvements in the structure and content of examination working papers. After allowing time for DOS's program to mature and incorporate what we view as needed enhancements, we will revisit pursuing such an audit to further assess the effectiveness of the Internet banking examination process. This audit would be based on a more complete evaluation of examination working papers and other factors related to the implementation of DOS's examination program.

CORPORATION COMMENTS AND OIG EVALUATION

On October 14, 1999, the Director, DOS, provided a written response to the draft report. The response is presented in appendix I of this report. The Director, DOS, stated that he would complete actions to address the report's findings by September 30, 2000.

The Corporation's response to the draft report provided the elements necessary for management decisions on the report's recommendations. Therefore, no further response to this report is necessary. Appendix II presents management's proposed action on our recommendations and shows that there is a management decision for each recommendation in this report.

**FDIC**Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429**CORPORATION COMMENTS****APPENDIX I**

Division of Supervision

October 14, 1999

MEMORANDUM TO: Steven A. Switzer
Deputy Inspector General**FROM:** James L. Sexton
Director**SUBJECT:** OIG Draft Report: DOS Actions Regarding Internet Banking

The Division of Supervision (DOS) is pleased to provide our official response to the Office of Inspector General's (OIG) draft report entitled, DOS Actions Regarding Internet Banking. Our response addresses the specific findings of the report and also outlines DOS' plans for implementing corrective action relative to the four recommendations that are contained in the report.

GENERAL COMMENTS

In general, DOS agrees with the findings and observations presented by the OIG in the draft report. In particular, we recognize the OIG's observation that DOS has established a "sound framework for evaluating Internet banking practices at FDIC-supervised financial institutions." This finding is consistent with the comments expressed by the GAO in their recent audit of Internet banking activities and regulatory oversight.

The OIG's report summarizes an audit survey that consisted of limited staff interviews, review of internal guidance and procedures related to electronic banking, research of certain examination databases, and review of three sets of examination work papers. The stated objective of the survey was to "identify and evaluate DOS practices regarding Internet banking to determine the nature, timing, and extent of audit procedures needed to further evaluate the effectiveness and efficiencies of these practices." Ultimately, the OIG determined that further audit work would be more effective if delayed pending DOS' opportunity to address certain issues and implement related OIG recommendations.

DOS agrees that a delay of further audit work would be appropriate. However, the OIG's proposal to revisit the area for a full audit within the next 12 to 18 months leaves limited time for the implementation of corrective action. DOS would therefore like to propose that the audit commence no earlier than 18 months from the date that the final version of the subject report is issued.

COMMENTS ON AUDIT SURVEY BACKGROUND AND RESULTS

Upon close review of the draft report, DOS staff identified a few points that are worthy of comment or clarification. Specific comments are provided below:

The draft report notes (on page three) that the GAO recently completed an audit of regulatory oversight of Internet banking and recommended that the FDIC address the need for greater examination coverage of third party vendors offering Internet banking services. DOS would like to note that the GAO's recommendation was directed at all of the Federal banking agencies, not just the FDIC. Also, the banking agencies, through the FFIEC Information Systems Subcommittee, have already implemented a supervisory program addressing Internet banking vendors.

See
Comment 1
below

On page three, the draft report references three DOS management systems that "track information related to bank examinations involving Internet banking." These systems are identified as the Electronic Banking Data Entry System, the Bank Information Tracking System (BITS), and the Scheduling Hours and Reporting Package (SHARP). It should be clarified that BITS and SHARP serve purposes entirely unrelated to electronic banking examination activity. BITS contains data derived from banks' financial performance and examinations; however, no specific electronic banking data is tracked in BITS. Similarly, SHARP contains information pertaining to examination activities and work hours; however, the only data relevant to the area of electronic banking consists of examiner hours spent on electronic banking activities.

See
Comment 2
below

A comment on page three implies that the Electronic Banking Examination Procedures use three "risk levels to categorize a bank's Internet activity and the associated level of examination." DOS would like to clarify that the Electronic Banking Examination Procedures use three levels to define the functionality of electronic banking systems. These levels are based on the capabilities permitted by the system and are intended to guide examiners in performing an appropriate scope of review. The degree of risk inherent in a given system does not singularly depend on the level of functionality; rather, it depends on management's implementation of appropriate controls and procedures. This distinction is important in light of DOS' risk-based approach to examination and reliance on examiner judgement.

Page four of the draft report references technical examination guidance on the subject of electronic banking. A "draft version of comprehensive information technology technical procedures supplements the safety and soundness procedures" is mentioned. It should be clarified that DOS has developed three draft technical work programs that address the Unix operating system, the NT operating system, and firewalls. These three work programs were introduced in 1997 and remain in the field testing stage.

Comment 1: While BITS and SHARP serve several purposes, the fact that they are management information systems that report upon all DOS bank examinations makes them relevant to Internet banking examinations.

Comment 2: Risk is inherent to DOS's method of categorizing a bank's Internet activity, as well as examining that activity.

RESPONSE TO RECOMMENDATIONS

The following summarizes DOS' response to the four specific recommendations outlined in the OIG's draft report. As required by the conditions of the Inspector General Act, as amended, and related guidance, our response addresses: (1) the specific corrective actions already taken, if applicable; (2) corrective actions to be taken along with the expected completion date for their implementation; and (3) documentation that will confirm completion of corrective actions.

Three recommendations are specifically targeted at field examiners' implementation of the DOS Safety and Soundness Electronic Banking Examination Procedures. These recommendations include ensuring that: (1) examiners use the Internet and FDICnet during examination planning to identify Internet banking activities and apply appropriate procedures; (2) electronic banking training emphasizes use of the FDICnet and Internet during the exam planning phase; and (3) examiners document their research of Internet banking activity within examination work papers and planning memoranda. DOS generally agrees with these recommendations and plans to take corresponding action.

Specific Corrective Actions Already Taken:

Initiatives to alert DOS examination staff to the importance of using internal resources, such as the FDICnet, to identify Internet banking have already been initiated. During two recent regional training conferences (New York Region and San Francisco Region), breakout sessions were conducted on electronic banking. During these sessions, examiners were reminded to utilize specific tools such as the Electronic Banking Data Entry System and internal lists of known Internet banks during the pre-exam process. Once examiners identify Internet banking, they have been directed to review the bank's Internet site to determine the extent of its functionality.

Also, all DOS assistant examiners that attend the Introduction to Examinations core training session receive instruction on electronic banking and the Electronic Banking Examination Procedures. During these sessions, the attendees are reminded to use the FDICnet and the Internet to identify Internet banking activities during the pre-examination process.

Corrective Actions to be Taken and Related Timeline:

To ensure that examiners utilize resources available on the FDICnet, and in turn, review the bank's web site on the Internet, the list of risk scoping activities utilized by safety and soundness examiners will be updated to address this activity. Specifically, the practice of reviewing the Electronic Banking Data Entry System for evidence of electronic banking will be added to the list of pre-examination activities that are outlined in the Examination Documentation (ED) modules. This addition will be completed in the next regularly scheduled update to the ED modules, which occurs in January 2000.

With respect to examiner training, DOS is anticipating "refresher" electronic banking training for safety and soundness examiners. We expect to begin training during the summer of 2000. The training will provide an opportunity to enhance examiner awareness of electronic banking in general and clarify issues related to the Electronic Banking Examination Procedures. Items such

as pre-examination activities would be emphasized during the training. DOS plans to determine an appropriate and feasible training strategy in early 2000. A variety of approaches and venues will be considered which take into account other DOS training initiatives and commitments. A plan, detailing the objectives, content, and schedule for the electronic banking training, will be completed in early 2000.

The DOS Manual of Examination Policies contains a section on work paper documentation that provides general guidance and direction on work paper development and retention. However, the section does not specifically enumerate certain documents that must be retained at every examination. Given the wide range of examination procedures and activities conducted at safety and soundness examinations and the variety of financial institutions examined, such specificity would not be meaningful in all situations. However, guidance on electronic banking related work papers will be incorporated into the existing Electronic Banking Section of the DOS Manual. This guidance will state that the electronic banking work papers should contain documentation to support that examiners have reviewed available resources to identify the existence and extent of Internet banking activities. Revisions to the Electronic Banking Section of the manual will be incorporated into the next regularly scheduled update, which will occur in the first quarter of 2000.

Documentation Confirming Completion of Corrective Actions:

Documentation that will confirm DOS' completion of corrective actions will include the following:

Page 1 of the Risk Scoping Activities Module in ED will be updated to include the item, "Electronic Banking Data Entry System." A copy of the updated document will be provided to the OIG as evidence that appropriate corrective action has been completed.

Materials describing DOS plans for electronic banking "refresher" training will be provided to the OIG to demonstrate the content of the sessions and confirm that pre-examination activities were properly addressed. These materials will be made available when the training plans have been formalized in the first quarter of 2000.

In connection with the next regularly scheduled update to the DOS Manual of Examination Policies, the Electronic Banking Section will be updated to include guidance related to work paper documentation. A copy of the updated section will be forwarded to the OIG as confirmation that appropriate corrective action has been completed.

The draft report also contained a fourth recommendation addressing the content of the Electronic Banking Examination Procedures. This multi-part item involves revising the procedures to provide: (a) detailed instructions for determining the connectivity between an institution's Internet banking site and its internal computer systems and when to make this and other key examination decisions; (b) directions for documenting key process determinations within the work papers; and (c) requirements that Internet banking examination work papers and reports be independently reviewed and that the review be documented in the work papers. DOS generally agrees that enhanced instructions regarding the determination of connectivity between an

institution's Internet banking site and its internal computer systems would be beneficial. Guidance regarding other key determinations, such as consultation with Electronic Banking Subject Matter Experts could also be improved.

Specific Corrective Actions Already Taken:

DOS has already commenced the process of soliciting field examiner input on improvements to the Electronic Banking Examination Procedures Module in ED. Examiners have specifically been asked about the clarity of instructions regarding the determination of connectivity between a bank's Internet system and its internal operations. Examiners have also been asked to comment on other key issues such as instructions regarding the three levels of review and consultations with specialists. Examiner input will be incorporated into the next revision of the Electronic Banking Examination Procedures in the ED update scheduled for the first quarter of 2000.

Corrective Actions to be Taken and Related Timeline:

Parts (a) and (b) of recommendation #4 will be addressed via a combination of updates to the Electronic Banking Examination Procedures and the Electronic Banking Section of the DOS Manual of Examination Policies. Part (c) of recommendation #4 will be addressed via DOS' existing field office audit program. In order to ensure that technical aspects of the electronic banking review were properly addressed, personnel conducting the review of electronic banking work papers will consult with Electronic Banking Subject Matter Experts as needed. Although some regional offices already incorporate electronic banking in their field office review programs, instruction will be provided to the regional directors to ensure that all field office review programs encompass such activities. Written guidance will be issued to the eight regional directors by year-end 1999.

Documentation Confirming Completion of Corrective Actions:

Documentation confirming the completion of parts (a) and (b) of recommendation #4 will consist of updates to the existing Electronic Banking Examination Module in ED and the Electronic Banking Section of the DOS Manual. Copies of the amended materials will be forwarded to the OIG as confirmation that corrective action has been implemented.

Activities addressing part (c) of recommendation #4 will consist of enhancements to the DOS field office audit programs to incorporate a review of electronic banking examination work papers. A memorandum will be issued to the regional directors updating field office review guidance. The OIG will be provided with a copy.

CONCLUDING COMMENTS

DOS appreciates the opportunity to comment on the observations and findings from the OIG's audit survey of the Internet banking area. We fully intend to appropriately implement the specific recommendations and will provide relevant documents to the OIG that will confirm the completion of corrective action.

DOS agrees with the OIG that Internet banking will continue to play an increasingly important role in the delivery of financial products and services in the future. DOS is committed to

keeping pace with the risks and supervisory challenges that are presented by developments in banking technology. Enhancements to electronic banking and other information systems examination programs will be considered and implemented as needed to address relevant industry trends.

Please direct any questions regarding this response to Examination Specialists Cynthia Bonnette or Phyllis Zumbrun.

cc:

Mr. Zamorski

Mr. Schmidt

Ms. Frank

Mr. Snyder

Mr. Lane

Ms. Koechel

Mr. Walsh

Mr. Cook

Ms. Zumbrun

Management Decision Table

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid. Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written responses to our report and subsequent discussions with management representatives.

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Documentation That Will Confirm Final Action	Management Decision
1.	The Corporation agreed with the recommendation. To ensure that examiners utilize resources available on the FDICnet, and in turn, review the bank's web site on the Internet, the list of risk scoping activities utilized by safety and soundness examiners will be updated to address this activity. The practice of reviewing the Electronic Banking Data Entry System for evidence of electronic banking will be added to the list of pre-examination activities that are outlined in the Examination Documentation modules.	January 31, 2000	DOS electronic banking examination work papers and planning memorandums	Yes

Rec. No.	Corrective Action: Taken or Planned	Expected Completion Date	Documentation That Will Confirm Final Action	Management Decision
2.	<p>The Corporation agreed with the recommendation. Initiatives to alert DOS examination staff to the importance of using internal resources, such as the FDICnet, to identify Internet banking have already been initiated such as during two recent regional training conferences in New York and San Francisco. Also, during Introduction to Examinations core training, assistant examiners are reminded to use the FDICnet and the Internet to identify Internet banking activities during the pre-examination process. DOS is anticipating "refresher" electronic banking training for safety and soundness examiners, where pre-examination activities will be emphasized, which will begin during the summer of 2000. A plan, detailing the objectives, content and schedule for this electronic banking training, will be completed in early 2000.</p>	September 30, 2000	DOS electronic banking examination training plans and materials	Yes
3.	<p>The Corporation agreed with the recommendation. Guidance on electronic banking related work papers will be incorporated into the existing Electronic Banking Section of the DOS Manual. This guidance will state that the electronic banking work papers should contain documentation to support that examiners have reviewed available resources to identify the existence and extent of Internet banking activities.</p>	March 31, 2000	DOS electronic banking examination procedures, work papers and planning memorandums	Yes
4.	<p>The Corporation agreed with the recommendation. The recommendation will be addressed via a combination of updates to the Electronic Banking Examination Procedures and the Electronic Banking Section of the DOS Manual of Examination Policies. In addition, instruction will be provided to the regional directors to ensure that all field office review programs now incorporate electronic banking activities.</p>	March 31, 2000	<p>DOS electronic banking examination policies and procedures</p> <p>Memorandum to Regional Directors.</p>	Yes